RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Feb. 11, 1987 **LETTER 958**

Jan. 30 DJIA 2158.04; PTI 2507; A-D Ratio -4.94
Feb. 6 DJIA 2186.87; PTI 2529; A-D Ratio -3.90

THE MARKET: Technicals: On February 2 the advance-decline ratio, after an extended period of divergence, finally bettered its April 21, 1986 peak. This means that the MAJORITY of stocks on the NYSE have now rallied above their high of nine months ago. This is obviously a major technical plus. The market's extraordinary upside action has been confirmed by new highs in all the widely followed Averages as well as by such disparate indices as the AMEX Average, the Value Line, the NASDAQ, and the Wilshire. My Primary Trend Index (PTI, see page 2 chart) has vaulted far into new high territory.

The rise has been GLOBAL in scope (as are all primary movements). Most of the world's exchanges are at their highs, and although few have noticed it, the Financial Times Industrial Average is now within a few points of the critical 1500 level while Japan's Nikkei Stock Average is flirting with the important 20,000 level.

The US market presents a fascinating paradox. On one hand, we have a market that, during January-February, surged on tremendous upside MOMENTUM. History suggests that this kind of initial upside momentum tends to trigger an extended rise, a rise that may continue even after the advent of the first correction (and, of course, we have not even had a first correction yet). On the other hand, we have a market that, on any historical measurement, is now OVERVALUED. Overvalued markets tend to be very difficult markets. Furthermore, overvalued markets often give way to important tops.

In view of my very recent cautionary Letters and the above paradox, people are writing to ask me if I have a Federal Express or Special Delivery service through which I can warn subscribers when I finally announce "a major sell signal." The answer is that I don't have such a service. And I'll explain why.

There's nothing in the Dow Theory that tells us to buy or to sell on the basis of either a Dow Theory bull signal or bear signal. Such signals are merely CONFIRMATIONS of the fact that the primary trend of the market has finally turned up or down. The great Dow Theorists always buy their stocks on the basis of great values. By the same token, they sell on the basis of their stocks being overvalued. In other words, true Dow Theorists invariably take action BEFORE the actual Dow Theory signal. I have tried to get this concept across to my subscribers many times in the past; my most recent effort appeared in the last Letter.

How do we know when stocks are overvalued? I went over this in the last Letter, but I'd better do so again. VALUE judgments for stocks can be coldly objective. The value measurements I use are yields, price/earnings ratios, and book values (again see the last Letter).

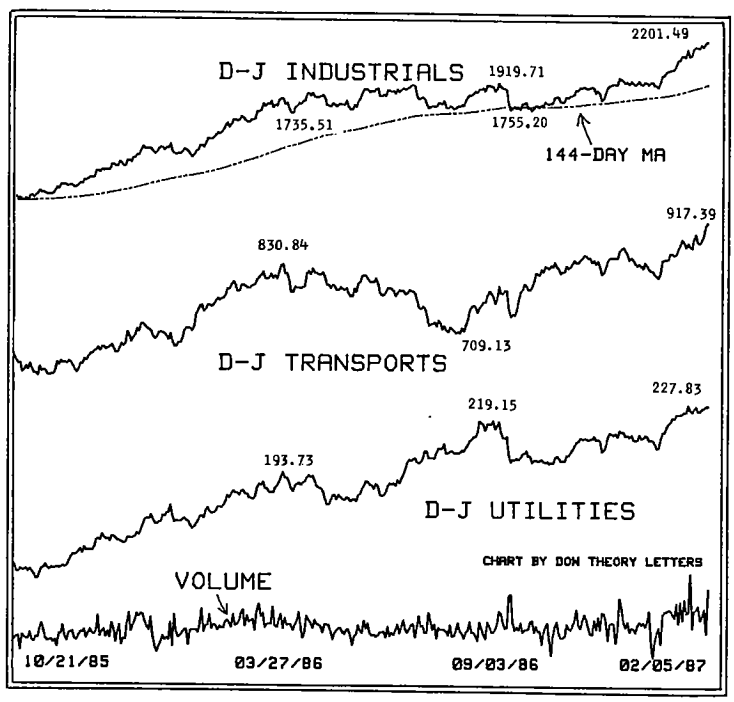
Actually, for purposes of calling major tops and bottoms, value judgments can be COMBINED with the various other phenomena such as the phases of a bull or bear market, price action of the market, investor sentiment, short interest, moving averages, and such. But as far as the Dow Theory is concerned, all major market judgments START with the concept of values. As Charles H. Dow wrote (and I never get tired of repeating this), "To know values is to know the meaning of the market."

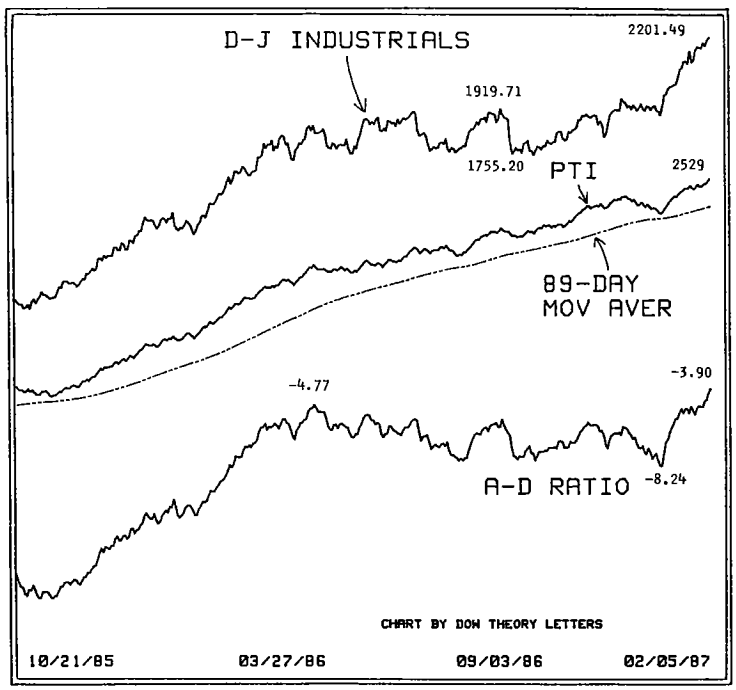
No market method that I have ever seen or heard of will pinpoint the exact bottom of a bear market or the exact top of a bull market. Seasoned investors can often sense when a bear market has settled into a major bottom. And they can usually sense when a bull market has rallied into a top area (although tops are usually more extended than bottoms and are far more difficult to identify).

Back in December 1974 when I was lucky enough to call the bottom of that terrible bear market, I had many things going for me. Stocks were cheap, selling far below book value and P/Es were absurdly low. Investors' sentiment was black. The Dow had sunk to the 500s and "experts" were openly predicting 300 and 250. Speculation was totally absent from the market, the public was battered and exhausted. Yields on stocks were high, and great values in equities could be found at every turn. To put it succinctly, at the '74 bottom they were "giving the market away." Based on all these considerations, I sent out my "Special Report" of December 20, 1974. In that report I recommended BUYING stocks across the board.

But note this: it wasn't until my February 5, 1975 Letter that I could write the following: "On January 27, 1975 the D-J Industrial and Transportation Averages closed above their preceding peaks of 674.75 and 156.61. On the method put forth by Charles Dow at the turn of the century, the joint penetration of the two Averages confirm what we have already suspected. We have been in a primary bull market since October 3, 1974."

Now I am not including the above quote as a belated boast or as a sales pitch to potential new subscribers. I am including it to demonstrate that we had ALREADY TAKEN ACTION in December 1974 two months BEFORE the actual Dow Theory bull signal. We had already bought stocks on the basis of values, sentiment, intuitions, and, lastly, price action. The historic Dow Theory bull market signal of January 27, 1974 merely CONFIRMED that our buying in late-1974 had been correct.





All right, on to the present. In the last Letter I included a good deal of data, all aimed at showing subscribers that this market was becoming overvalued. Why the sudden warning? Why have I turned cautious after years of bullishness? Consider this: From its December 31, 1986 low, the Dow rose an extraordinary 284 points in a matter of a few weeks. How could that happen? In my opinion, what has happened is that via the "miracle" of our new computer-driven stock market, Wall Street was able to accomplish in a few weeks what it might ordinarily have taken a year or more to do.

By early-February 1987, according to my criteria, the blue-chip stocks had rocketed into the overvalued zone. When that happens, history tells us that the market is treading on thin ice. Mind you, one can walk across a lake of thin ice and make it to the other side. But veteran woodsmen have learned to respect a frozen lake when the ice is thin. They have seen too many men drown or freeze when they break through that ice into the 32-degree water.

So what I'm saying now is this: we are now at the point where good stocks (the kind of stocks informed investors deal in) are selling at high prices and low yields. The Dow YIELD is now down to a minuscule 3.05%. The Dow itself is now selling at better than twice its BOOK VALUE. The Dow is also selling at an expensive 18.2 TIMES EARNINGS. All of these statistics put the Dow in the overvalued zone. Sure the market could go higher, sure the Dow could sell at 19 or 21 times earnings. But my feeling is that we must be on our guard here.

One other value-related item: I spoke to Geraldine Weiss of Investment Quality Trends (see last Letter and also Letter 956), and she informs me that her percentage of blue-chip stocks in the "undervalued zone" is now down to a mere 12%. At the same time, the percentage of blue-chip stocks in the "overvalued zone" has climbed to a very high 30%. These are the exact same percentages that existed at the 1968 market top. So the Weiss statistics confirm my own judgment that we are dealing with an overvalued market.

"Russell," you challenge, "stop the veiled warnings. What signal are you looking for that would tell us to actually get out of this market?" My answer is that there are a number of definitive signals that could appear. We could get a primary bear signal under Dow Theory (but this would obviously take time). Or my PTI could turn down and trace out a bearish pattern. Or the market could simply turn down and continue declining in a relentless fashion until all the key moving averages were violated.

At this phase of the bull market, in an area where stocks are clearly overvalued, any of the above possibilities would constitute an all-out sell signal. But aside from potential sell signals, the point I want to make in this Letter, the major point, is the market has now moved into the "overvalued zone." This is the area where we should be thinking in terms of distribution, of selling stocks and taking profits -- rather than buying stocks in a low-yielding, speculative market.

Question: Russell, what about the thousands of secondary or less-than-blue-chip issues? Many of these stocks have not moved, and many of them still represent good value. Furthermore, many secondary stocks offer fat yields. What's wrong with buying them?

Answer: For the most part, the economy of the mid-1980s has benefited the big companies, the companies with consumer acceptance, the companies with big advertising budgets, the companies (most recently) with good export capabilities (and particularly companies with foreign manufacturing facilities). Meanwhile, the little guys have had to struggle, and their lagging stocks indicate this.

Historically, it is the investment-grade issues (typified by the Dow stocks) that SET THE TREND of the market. Primary bull and bear signals are given on the basis of the D-J Averages, not, for instance, on the basis of the low-priced stock indices or the NASDAQ Index. When the big stocks finally top out and move down in a primary bear market (or even in a secondary correction), the whole market will go with them. I don't care how cheap the secondary stocks appear, when the big guys fall out of bed, the little guys will swoon too.

Question: With all the liquidity around, how could we possibly have a bear market?

Answer: Only one phenomenon can produce an extended bull market, and that is a forthcoming rise in corporate profits. A great many other factors can stimulate a bull market such as favorable political factors, improving foreign relations, low inflation, rising liquidity, declining interest rates, to name a few. Ultimately a bull market depends on rising corporate earnings. I don't care how much liquidity there is, if that liquidity can't be translated into improving corporate profits, you're not going to have an extended primary bull market.

Question: The general feeling is that corporate profits will be up at least 10% in 1987, maybe as much as 15%. With that background, how can the stock market be vulnerable to a correction?

Answer: The stock market's function is to discount, to deal with tomorrow. The phenomenal rise in the market since 1984 has obviously discounted improved corporate earnings. The good news is already built into the averages. Remember, the stock market tends to look anywhere from six months to a year or more AHEAD.

Question: You've talked about your Primary Trend Index as your fail-safe instrument. Won't the PTI warn us or provide a sell signal when the time comes?

Answer: Yes, but remember, the PTI cannot pinpoint an exit level nor can it pinpoint an entrance level. The PTI was designed to keep us on the RIGHT SIDE of the main trend. But study the PTI on the page 2 chart. It is now far above its 89-day moving average. If, for the sake of argument, the market was to turn down tomorrow and then crash by the end of the week, we would not have a PTI signal in time. Nevertheless, the PTI would keep us out of perhaps 90% of a major and extended bear market.

To recount some history, the PTI turned down in January 1973 and remained in a major downtrend until December 1974. During that ghastly period the PTI was of tremendous help to me and my subscribers in that it kept us out of the market despite many powerful and inviting counter-trend rallies. Still, I was pretty bearish on my own in early 1973, regardless of the PTI. The PTI bear signal simply told me that my bearishness was correct.

I would say in the current situation that if one has fat profits and doesn't mind giving up maybe 10% or so of those profits, one could wait for an actual Dow Theory bear signal or an actual PTI bear signal before selling.

Question: Russell, if this market turns down in an important way, how will we know whether what we're looking at is just a correction or the beginning of a primary bear market?

Answer: Unfortunately, at this stage of the game, there is no way of knowing. However, when values get this thin, the possibility of a primary bear market starting can never be discounted.

FURTHER THOUGHTS: I find myself wondering what kind of people buy stocks ON TOP of a rally that has gone up better than 300 Dow points in a little over a month's time. I guess the answer is (1) dyed-in-the-wool optimists, (2) people who know little of stock market history, (3) people who are just plain desperate to get into an exploding market.

Comparisons: This stock market advance began on July 24, 1984 with the Dow at 1086.57. The Dow has now risen 102% without suffering so much as a 10% correction. This makes the 1984-87 rise the greatest (in PERCENTAGES) in history without an intervening 10% correction. The previous uncorrected record advances were from 3/31/33 to 7/18/33 which advanced the Dow 96.2%, and the advance from 7/8/32 to 9/7/32 which advanced the Dow 93.9%. However, both of these advances occurred within a period of less than four months and both of these occurred at much lower Dow levels and both followed closely on the heels of the greatest bear market (1929-32) in history.

The current advance, having started in July 1984, has now lasted almost 30 months. During those 30 months we have not seen so much as a 10% correction in the Dow. In terms of DURATION, the previous record rises (without intervening corrections of 10% or more) were as follows: the advance from 7/13/50 to 1/5/53 lasted for 29.7 months and advanced the Dow 75.4%. The advance from 6/26/62 to 5/14/65 lasted 34.6 months and advanced the Dow 75.4%.

So putting the current advance in PERSPECTIVE, the Dow has now risen for almost 30 months and it has gained over 100%. Thus, in extent, it is the greatest uncorrected advance in history, and in duration it is the second longest uncorrected advance in history. Statistics on the D-J Averages go back to 1895, and new all-time records are difficult to come by. Certainly, a record for extent of an advance and a near-record for duration is extremely difficult to achieve. Conclusion: This market is not only overvalued, the advance is stretched thin in terms of both duration and extent.

GAMBLING: Many market veterans are now claiming that Chicago runs the NYSE. How? Via the option/ index spreads. I am not going to discuss how the option spread works (any broker can explain this to you), but what is interesting is that it now takes less than 7 seconds to complete a computer-triggered option "program." Thus, millions of shares are now bought and sold (automatically and almost instantly) every day, and all this furious trading is based on option/index spreads rather than on investment considerations.

What has happened is that the boys have turned the NYSE into a giant gambling casino, a financial Vegas but on a far larger scale. My thinking is that we will live to regret this before the bull market is over, and certainly we will have reason to regret it when the next primary bear market is in force.

OVERVIEW: I have tried to show several things in the last few Letters. (1) We have a market that has produced a record advance spurred on by extraordinary upside momentum. (2) We also have a market that is now overvalued. In view of these two items, what can one expect in the months ahead?

The "normal" expectation following this kind of display of upside momentum would be a correction which might retrace one/third to one/half of the advance, and then another advance to new highs, probably to substantial new highs.

A second possibility following a super-strong advance would be a few months of tedious sideways action, and then a continuation of the upward trend (this is what occurred between April 1986 and December 1986).

A third possibility based on the current overvaluation of the market would be the formation of an important top here -- and then either a full secondary reaction or a primary bear market.

Which one will it be? I can say that after 40 years of experience with the markets -- I have NO WAY of knowing, and neither does anyone else on the face of this green earth! I simply hope to IDENTIFY the outcome as it materializes.

I'll close this section with this observation: Only amateurs or fools demand certainty in the market. Veteran market students know better, and they only ask for an intelligent presentation of the probabilities.

INVESTMENT POSITION: The bull is in the box. It's an overvalued market, but it's STILL a bull market. So we SIT with the bulk of our holdings.

In a current issue of the well-known "Bullish Consensus" report, publisher Earl Hadady states, "After looking at the phenomenal rise from the 12/31 low and the 120 point shakeout, 1/23, I can see how the Dow will go to 3,600 (as Prechter and Eliades predict) WITHOUT ANYONE MAKING A DIME!"

Russell comment: I don't agree. I have stated repeatedly over the past few years that this is a "buy 'em and hold 'em" market. Furthermore, those of us who bought and held have done well, even though this market has been a tough one to stay with (let's face it, all bull markets are tough to stay with!). But that's how the real money is made in bull markets. You buy good, dividend-paying stocks and sit with them until the danger signs appear. Then you sell out and once you sell out, you stay out. So basically, we're still holding.

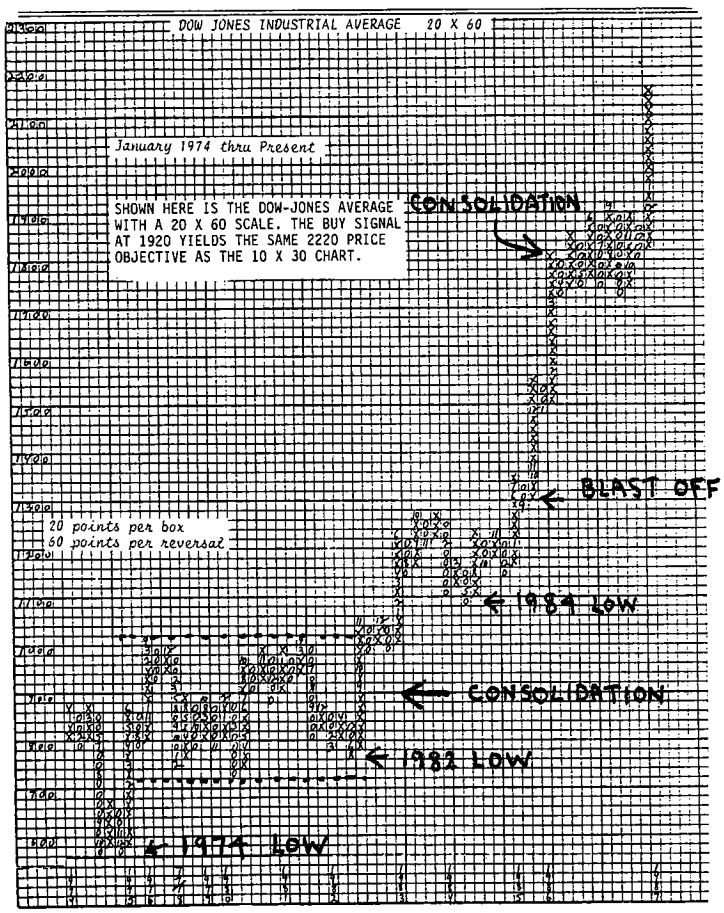
Incidentally, I haven't said much about bonds lately. As you know, over the last few years I've advocated buying good-quality municipal bonds. Last year, for a while, tax-free munis were actually providing higher yields than taxable Treasury bonds. Why? Because people were worried about and confused by the the new tax bill, and they didn't understand that munis were a bargain compared with Treasuries.

I think munis are still a bargain compared with most other available investments. You can get 6.5% to 7.5% tax-exempt yields right now at a time when longer-term T-bonds are yielding around 7.7% (taxable) and the Dow is providing a very skimpy 3.09% (taxable) yield.

For some reason that I don't understand, people think the new tax bill is going to be a bonanza for them. Forget it. For most people, the combined federal and state tax (add the city tax for New Yorkers) is still going to be high. For instance, the maximum combined (state and fed) tax for Californians in '87 will be 45.3%. At that rate, a 6% Cal muni yield is equal to a 10.97% taxable yield, and a 7% Cal muni yield is equal to a 12.80% taxable yield. Another example, the maximum combined fed, state, city tax for NYC dwellers in '87 will be 49.6%. At that rate, a 6% NY muni is equal to a 11.32% taxable yield, and a 7% NY muni is equal to a 13.89% taxable yield. So you can see what I mean. Muni yields from your own state (particularly if you live in a high-tax state) are still VERY impressive compared with almost any other investment.

DOW: This is a follow-up on a study which appeared in Letter 954. At that time the Dow was just breaking out of its long consolidation pattern, and I included a point & figure chart with a "count" or a price projection. The projection was for the Dow to reach at least 2220.

The accompanying chart is another P & F chart (courtesy of Chartcraft, Box 2046, New Rochelle, NY 10801), but this one covers a longer period of time than the one in Letter 954. This is a 20 x 60 chart, which means that each box on this chart is equal to 20 Dow points, and only rallies and declines of 60 points or more are shown. Rows of Os denote declines, rows of Xs denote advances. This chart presents a very concentrated picture of the Dow, and on a single small chart it shows all the Dow action going back to 1974.


DOW JONES INDUSTRIAL AVERAGE 20 X 60
January 1974 thru Present
SHOWN HERE IS THE DOW-JONES AVERAGE WITH A 20 X 60 SCALE. THE BUY SIGNAL AT 1920 YIELDS THE SAME 2220 PRICE OBJECTIVE AS THE 10 X 30 CHART.
CONSOLIDATION
BLAST OFF
20 points per box
60 points per reversal
1984 LOW
CONSOLIDATION
1982 LOW
1974 LOW

Through the use of this chart, I want to show how a bull market works. At the exteme left of the chart we see the 1974 sector of the 1973-74 bear market. That costly bear market took the Dow down to an extreme low of 577.60 in December 1974. From there, a new bull market began. The new bull market advanced the Dow to the 1020 box in 1976.

From the 1976 high the market underwent a long and frustrating series of gyrations. We now know that this period represented an area of bull market consolidation and accumulation. Note the "wipe out" of 1982, a final vicious decline that scared all but the most committed bulls out of the market. But the 1982 decline served a purpose; it put stocks back into the strong hands again.

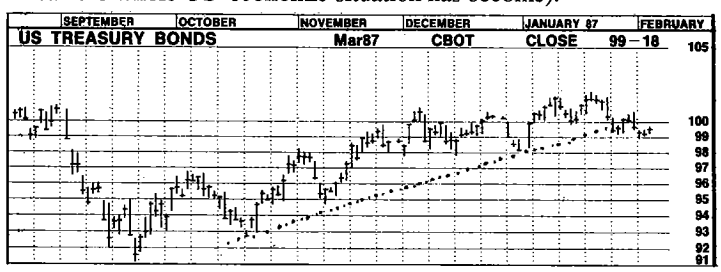
In January 1983 the Dow broke out of the consolidation pattern and roared up to the 1280 box on the chart. Again, the market corrected, and again the Johnnie-come-lately bulls were knocked out of the market. The Dow retreated to the 1100 box in May of '84.

In January 1985 the bull market pushed higher, entering into what I call the "blast off" phase. From the 1985 low at the 1100 box, the Dow rallied up to the 1986 high of 1920. Here again, the Dow and the market fell back into a consolidation pattern.

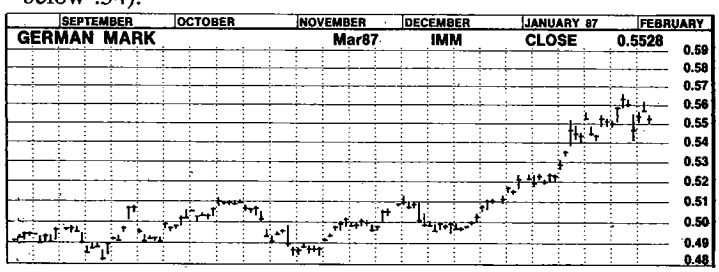
In December 1986 the Dow surged out of its consolidation pattern, and that surge gave way to the spectacular rise of January and February 1987. The nine-month consolidation of 1986 served as a base for the current move, and as I calculate it, the 1986 base should support a Dow advance to or near the 2220 level. In strong bull markets, such P & F targets are often surpassed. In bear markets or weakening bull markets, the upside "counts" tend not to be achieved.

But any way you look at it, the January-February rally has done its job. At its recent intra-day high, the Dow advanced to within a fraction of a percent of the 2220 target, and even on a closing basis the Dow has risen to within shooting distance of the 2220 target. It remains to be seen whether the Dow can better the 2220 target projection.

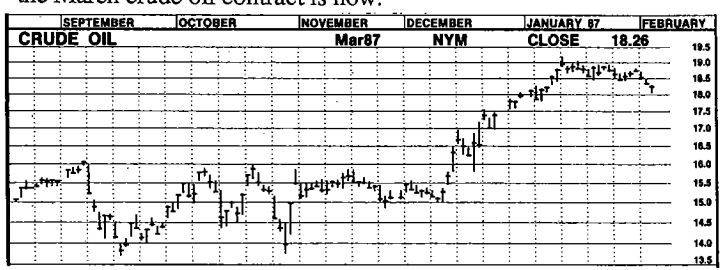
CHART COMMENTS: The T-bond (Mar. contract) has broken below a five-month rising trendline. So far, not much downside pressure has come from this break. However, the important support for the March bonds comes in at 98. Rumor has it that Japan is about to cut its discount rate, and that "hope" has been helping the US money markets (which is a sad commentary on how weak the whole US economic situation has become).

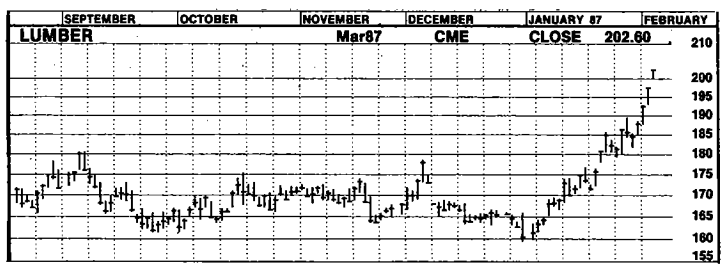


The German mark is typical of the stronger currencies, and here we see the mark in terms of dollars (Mar. contract). The mark is consolidating after its recent run-up, and many feel that the oversold dollar is finally ready to rally (if so, the mark should break below .54).



The talk is that the Arabs want to hold oil at roughly 18 dollars per barrel. The market seems to agree, because that's just about where the March crude oil contract is now.





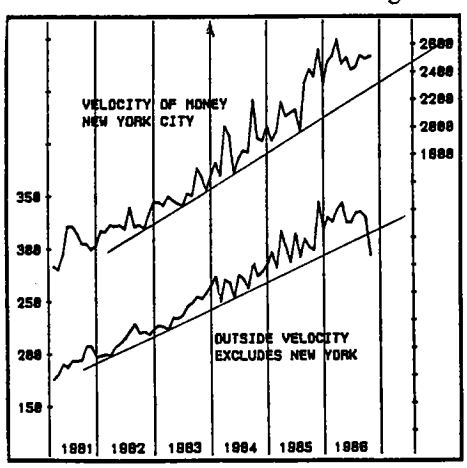
Auto sales may be drying up, but housing is booming (due to low mortgage rates). Lumber obviously likes the picture, and here we see the March lumber contract rocketing from January's 160 low to the current high over 200 --up a whopping 25% in a month!

NOTES & QUOTES: The San Diego Yacht Club's Stars and Stripes won the America's Cup. The winning club makes the decision on where the next race (scheduled for 1990) will be held. NBC's Bryant Gumbel says it will be held in Hawaii. See if you can get him to put money on it. My bet: 10 to 1 the defense of America's Cup will be held in San Diego. The 1987 race was unbelievably popular. Why? Because it represented more than anything else a triumph of American technology (and guts).

* *

During 1986 the M-1 money supply rose a big 16%. But over the last two months M-1 rose 32%. What's going on? In opposition to what most people think, the Fed cannot arbitrarily increase the money supply. It takes bank borrowing to do that. But by various methods the Fed can encourage the private sector to borrow. It is only when the commercial banks lend to their customers that new money is created.

This chart (courtesy Juncture Recognition, 3700 Galt Ocean Dr., Ft. Lauderdale, FL 33308) presents a most interesting picture. It shows velocity (demand deposit turnover) in NYC and outside NYC. Velocity outside NYC usually provides a good picture of the nation's business actitivity. As you can see on the chart, money velocity outside NYC has now broken a six-year trend, and that implies that business across the nation is slowing down.



However, velocity in NYC is still rising strongly. Why the strong action in NYC as opposed to the rest of the nation? NYC is the financial heart of the nation. Some of the NYC activity is probably due to borrowing to finance mergers and takeovers. And undoubtedly a good deal of the NYC borrowing is to finance stock purchases. Thus this chart is telling us that the real activity in the US is now financial as opposed to commercial. Business is slow, but the markets are hot. Sooner or later (probably sooner) velocity outside NYC had better turn up — otherwise, there's going to be trouble.

* *

Russell thought: In ANY profession, 5% of the practitioners are superb, 10% are smart enough to follow the superb 5%, and the rest (85%) will run from pretty good to average to incompetent. You better, when you need help, hire someone in the top 15%, and if possible the top 5%. How do you find out who the top 5% are? Ask questions, get recommendations, do some research, sweat. If you're too lazy to find the best, you're probably going to sweat anyway -- out of exasperation.

* *

How did it all end up in 1986? Well, diamonds were hot with D-flawless (the best) bouncing up from $10,750 to $14,500 -- up 35%. Sotheby's art index spurted 24.4%. Gold was up 18.6%. Equity mutual funds were up 16.1%, stocks (Wilshire Index) were up 16.1%, bonds were up 15.4%, and housing was up 4.7%. The bad news: silver was down 8.1%, commodities were down 8.8% (CRB Index), the dollar was down 12.4%, money market funds were down 20% (yields were down from 8% to 6.4%).

* *

Australia has become the "in" country of 1987, what with the America's Cup and "Crocodile" Dundee and now a great, new book. The book is "The Fatal Shore" by Robert Hughes (Knopf, $24.95). The book deals with the founding of Australia. No country in history was ever founded this way. Between 1788 and 1868, 825 shiploads of men, women, and children were shipped to Australia's penal colonies. Most of these luckless devils were criminals -- thieves, murderers, pickpockets, you name it. The book is beautifully written, chocked with fascinating facts and stories -- a classic a day after it was published. "The Fatal Shore" has drawn raves from critics everywhere. I couldn't put it down. I recommend it highly.

* *

I've seen dozens of "war movies" in my lifetime. But I've only seen one that captures the fear, the dread, of actual combat, when you know that at any second you may lose an eye, an arm, or your life (and I've been there). That movie is "Platoon." I have a two word critique for this masterpiece of realism: "See it."

* *

Gorbachev is anything but a fool -- and he's got a problem. He knows the Russian system doesn't work. The system just doesn't produce. Furthermore, it is suffering from social alienation, stagnation, corruption, and alcoholism. So Gorbachev has come up with plans to "restructure" Russia. The plans present the biggest threat to the Russian elite and privileged in recent history.

The new plans include election by secret ballot of party chiefs all the way from local districts to republic level. "Direct democracy" on the shop floor with workers being allowed to elect managers and executives. The new criteria for choice of party cadres and government officials will be deeds, not words or position in the party. Since these reforms present a tremendous threat to the existing order, opposition to Gorbachev's reforms is already intense. Gorbachev's current task -- to get rid of the opposition.

* *

Most people are unaware of it, but a number of Asian countries (Taiwan, Korea) have tied their currencies directly to the dollar. Thus, as the dollar falls, these countries couldn't care less -- the lower dollar helps their exports. As a result, watch the rise in sales for Hyundai and other Asiatic (non-Japanese) cars, and watch for new Korean importers. Of course, this situation is worrying the Japanese to no end.

* *

From our "This is the West" file: There are 1,278 licensed gun dealers in San Diego county (population 2 million). All these dealers are licensed to buy and sell guns. Some of these dealers are simply collectors, and others are "basement dealers" who sell weapons to friends and acquaintances, often near cost. Now get this: In the single year 1985 (based on the latest available figures) there was a total of 19,094 handgun sales in San Diego County alone and a total of 271,953 handguns sold in California. These are just handgun figures, they don't cover rifles and shotguns (shotguns are the weapons of choice for home defense here in the West).

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If you read the fashion magazines (which for some reason I do) you know that short skirts are in this year. The NFC Giants won the Superbowl. The January barometer is pointing up for January. And since WW II the market has never been down in a pre-presidential election year. All of these are reputedly bullish omens for the stock market. But readers also know that Richard Russell doesn't put any credence in bullish omens. ("It's those exceptions that kill you.") Anyway, it should be an interesting year.

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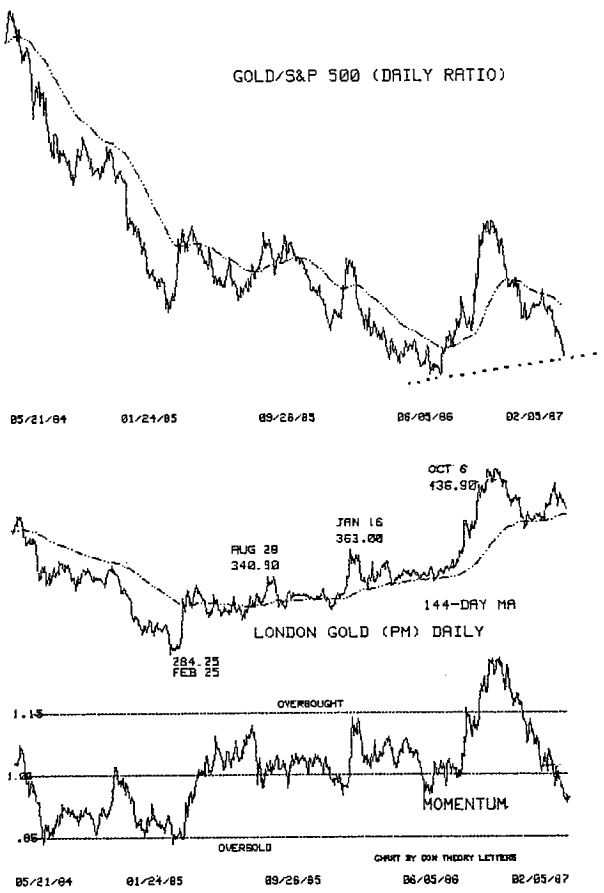
Honestly, I don't know about General Motors. A few months ago GM put up a ridiculous $700,000 to "buy off" Ross Perot, their sternest critic. More recently, Car and Driver magazine reviewed GM's Buick Riviera T Type car. The magazine said that while Buick was trying for "a theme of understated elegance," instead they came up with "understated incoherence." A companion review stated that the car drives "as nicely as skreeking chalk." So what did Buick do? In unheard-of action, it took back the loaner while the car was only part way through its 30,000-mile test (the car was loaned to Car and Driver for appraisal). In a follow-up story, Car and Driver called the Riviera's car service record "lousy."

GOLD: Few people understand the concept of insurance and even fewer understand the concept of owning real money. When you put a down-payment on a car, you don't really "own" that car. The reason you don't own the car is that if you can't make your next payment or the one after that you are going to lose the car. You're going to get a visit from the repossessor, and he's going to drive off with the Chevy you thought you owned.

Insurance is one of the few areas where you get the whole product on your first payment. For instance, when you buy a $500,000 life insurance policy, you "own" the full protection from the day the insurance company takes your check. If you drop dead that afternoon your spouse or mother or kids will get the full $500,000 and the insurance company has lost its bet (of course, they don't call it a bet, that's too low-brow a concept).

I've always had a hard time getting the concept of gold across to people. Buying gold is NOT like buying a stock in the early stages of a bull market (which is where stocks should be bought). When you buy a stock at the right time you aren't going to be fidgety. And you aren't going to be suffering from high anxiety because the bull market isn't catapulting your stock upward. The reason you'll be calm and patient is that you bought the stock as an INVESTMENT, and that stock is providing you with a YIELD of 7% or 10% while you wait for the bull market to get rolling.

Not so with gold; gold is not an investment. When you buy gold you get paid nothing -- no interest, no dividends. And I believe that's the real reason gold buyers (even when they buy at or near the beginning of a gold bull market) become obsessed with "higher gold prices." The fact is that most of us are greedy and most of us are "profit minded." But when you buy gold you should not be looking for a profit. What you are doing when you buy gold is (1) diversifying, and (2) buying insurance against either a depreciating dollar or a catastrophe which will destroy most of your other investments.



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Therefore, rationally, the gold buyer should hope that gold stays in a low area for as long as it takes him to accumulate his gold "insurance." Let me put it on a personal basis. Personally, I hope gold stays around 400 for the next two or three years. I'm not anxious to see gold skyrocket; such action would only mean that my dollars and my bonds are on the road to collapse. Frankly, if or when the gold bull market goes into high gear, I'll be sorry to see it happen. A big bull market in gold will be an indication of big trouble for America -- and that's the last thing you or I or beleaguered President Reagan needs.

Except for gold, almost any time you buy anything you are buying or taking on debt. When you buy a house you are probably going to take out a mortage. When you buy a car you usually finance it. When you own dollars you are holding legal tender, but that legal tender is depreciating, because there is a mountain of debt building up against it. When you buy a stock you are probably buying a share of a company that is loaded with debt. When you buy a bond you are buying some corporation's or some state's debt.

When you swap dollars for gold, however, you are reversing the process. Then you are trading a government's guarantee of legal tender for a coin that is real money (and real money doesn't need any guarantee). Gold is real money because it has intrinsic value. Gold is VALUE, pure and simple -- value wrested out of the ground by men's sweat.

I wrote the above because I want my subscribers to know what they are doing and what to expect when they buy Kronas or Krugerrands or Maple Leafs or American Eagles. So don't fidget around, hoping for gold to go to 600 by July. Don't worry about next week's or next month's price fluctuations. Buy those coins and put 'em away. The coins will outlast the rest of this Wall Street bull market, they'll outlast the next bear market, they'll outlast the current administration and all the administrations this nation will ever produce. Learn to understand gold. Those who buy gold for "a killing" don't understand it any more than do those who buy a Klee painting for "appreciation."

"Yeah, I get it, I get it," you retort, "but I still want to know about the gold price." Fair enough. From the standpoint of price action, this chart tells the whole gold story. The top line shows the ratio of gold divided by the S&P 500 (it's really a relative strength chart -- gold against common stocks). Relative strength on gold has come down hard, but incredibly the RS for gold is still above the July 2, 1985 low of 1.35. It's important that gold's RS hold above that level.

At the middle of the chart we see London gold (2nd fix) and the 144-day moving average (MA) of gold. The MA for gold is now 394, and gold continues to hold above this level. From the price action standpoint, therefore, gold is still in a bullish trend.

The bottom of the chart shows gold momentum or its 89-day rate-of-change (gold divided by its price 89 days ago). Following the late 1986 explosion, gold became very overbought, and it's been correcting ever since. Gold momentum is now down to its lowest level since early 1985.

A real test for gold could be coming up in the period ahead, since it appears to me that the dollar may have bottomed out -- at least temporarily. Technically, I'd say that the best thing about gold's performance over recent months has been that gold momentum has come down from overbought to almost oversold while gold has (during this whole corrective period) continued to hold ABOVE its 144-day moving average.

I continue to advocate a policy of buying gold coins on a fixed-dollar basis -- in other words, putting a fixed amount of dollars each month into the coins. This is boring, it isn't speculative, but it will give you the gold hedge on a dollar-averaging basis. As a gold dollar-averager, you don't care what happens to the price of gold. If the price of gold skyrockets, you boast to your friends that you're a bloody genius. If the price collapses, you continue to buy the coins while confiding to your friends that you're "buying bargain gold at a time when the poor fools are literally giving it away."